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TAGS: [SENV](#) [ENRG](#) [ECON](#) [TSPL](#) [TRGY](#) [KSCA](#) [IN](#)
SUBJECT: CARBON CREDITS SUFFICIENT BUT NOT NECESSARY FOR SUSTAINING
CLEAN ENERGY PROJECTS OF MAJOR INDIAN BUSINESS GROUPS

REF: A. A) Mumbai 302
 B. B) New Delhi 1935
 C. C) Kolkata 194

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11. Summary. (SBU) Despite the risk and uncertainty of qualifying for carbon credits (see ref A), Indian businesses have pumped USD 25 billion into unilaterally developing Clean Development Mechanism (CDM) projects to generate carbon credits. In discussions with ConGenoff and visiting analysts from the Government Accountability Office (GAO), executives of major Indian companies outlined their plans to earn carbon credits. All admitted that the adoption of clean technology is aimed at promoting sustainable development and that the search for energy efficient solutions is driven by high energy prices. Carbon credit boosters in Mumbai denounced the carbon credit validation and registration process as bureaucratic, lengthy and arbitrary, similar to what GAO heard during meetings in Delhi (see ref B). However, they conceded that no Indian project could meet the "additionality in investment criteria" to be eligible for carbon credits. Notwithstanding their own self-imposed motto of promoting sustainable development through clean technology, our interlocutors called for slackening the qualification requirements for carbon credits to "reward" all processes resulting in increased energy efficiency and lower direct or indirect carbon emissions. End Summary.

Indian Investors Pump in USD 25 Billion to Develop CDM Projects

12. (U) The National CDM Authority (India's designated national authority) has given host country approval to 969 Clean Development Mechanism (CDM) projects in India. Of this, 346 projects have been registered with the CDM Executive Board, the CDM supervisory arm of the U. N. Framework Convention on Climate Change (UNFCCC). (Note: The CDM allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement an emission-reduction project in developing countries where it is cheaper and more cost-effective. Such projects can earn certified emission

reductions (CERs) credits or carbon credits which count towards meeting Kyoto targets. Each credit is equal to one ton of carbon dioxide that would otherwise have been emitted if the project was not in place. After the CDM project receives host country approval, it is validated by an accredited international organization and then submitted to the CDM Executive Board for registration. The carbon credits generated by the registered CDM project are verified by one of the accredited validation organizations after which they are available for sale in the primary or secondary market. End Note.) These approved Indian projects, mainly in the areas of renewable energy and energy efficiency, could potentially generate 492 million CERs by 2012, assuming that they are successfully registered with the CDM Executive Board. However, India leads other countries in the number of projects rejected by the board. Twenty nine out of the 66 projects rejected by the CDM Executive Board are Indian projects. (Note: If more than three members of the CDM Executive Board object to the project, then it is returned for review. End Note.)

13. (SBU) India grants host country approval to a CDM project based on the sustainability criteria following a presentation by the project developer to demonstrate that the project promotes economic, social, environmental and technological well-being. In contrast, the CDM Executive Board checks whether the project is "additional" in technology and investment. (Note: The project has to prove that it does not use commonly-available technology and that it is unviable without carbon credit revenue. End Note.) At a seminar on CDM in Mumbai, R K Sethi, Member Secretary of the National CDM Authority and the present Chairman of the CDM Executive Board, publicly admitted that the National CDM Authority takes the "project developer at his word" for clearing the "additionality" barriers. Mathsy Kutty of Det Norske Veritas (DNV), a CDM Executive Board-accredited validation and verification organization for CDM projects, told ConGenoff that the designated authorities of host countries

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approve projects in a cursory manner and do not check to see whether the project meets all the requirements laid down by the CDM Executive Board. CDM projects in India do not have to be validated or verified to get host country approval while both processes are mandatory to get the project registered with the UNFCCC, she continued. For this reason, she pointed out, Indian projects account for 44 percent of the total projects rejected by the CDM Executive Board.

14. (SBU) CDM projects are developed unilaterally in India, with the project developer financing the project and seeking a buyer for CERs or carbon credits after the project is registered and begins to earn carbon credits. According to Pamposh Bhat, Director for Climate Change of GTZ, Indian investors have invested around USD 25 billion to develop CDM projects in India.

On the plus side, the CERs generated by these independently-initiated CDM projects are traded internationally and command a higher price as compared to CERs of bilateral projects that are funded by investors in EU nations to meet their emission-reduction commitments. The downside of initiating CDM projects without foreign backing is that the local project developer has to self-finance the project and bears the risk that the project does not qualify for carbon credits. For this reason, Santonu Kashyap of Asia Carbon maintains that Indian projects can never fulfill the additionality requirement as no developer will risk investing in a project unless he is certain of a revenue stream independent of the CDM incentive. In a separate discussion with GAO analysts and ConGenoff, Jamshed Irani, Director of Tata Sons and the Chairman of the Tata group's Steering Committee on Sustainability, agreed that no Indian company is brave enough to rely entirely on a CDM-driven revenue stream.

Major Indian Business Houses Forge Ahead to Earn Carbon Credits...

15. (U) Irani admitted that the Tata group is a late entrant to the cause of environment sustainability in its business operations. He noted, however, that some companies within the Tata group had developed innovative clean technologies to improve energy efficiency even before the Kyoto Protocol. For example, Tata Steel consumes less than one percent of liquid fuel to produce steel as compared to 20 years ago. Irani informed ConGenoff that a sponge iron plant, which re-circulates hot gases to generate power, has been earning carbon credits for the last three years. This project will earn enough carbon credits in the next 7-8 years to pay for the cost of constructing the plant, he continued.

16. (SBU) Dr. Avinash Patkar, Chief Sustainability Officer for Tata Power, said that the ultra mega power (UMPP) project at Mundra in Gujarat is awaiting registration with the CDM Executive Board. This project is based on supercritical technology which results in lower carbon emissions. DNV's Kutty is concerned that UMPPs will be rejected by the CDM Executive Board, as the use of supercritical technology in all UMPPs is a mandatory requirement stipulated by the Indian government. As this technology is the norm for all UMPPs, it has to be put in place by the project developer with or without the CDM benefit. Proving additionality is therefore difficult, she continued. (Comment: Ironically, DNV acted as the validator for the Mundra UMPP and, as per Patkar, has already validated the project. End Comment.) Pratap Melampati, who works with the Reliance ADAG group which is at different stages in getting two of its UMPPs qualified to earn carbon credits, argued that a project developer can always develop an independent power project of the same scale as the UMPP using sub-critical technology instead of bidding for a UMPP. Although not mandatory, the company is using supercritical technology in its 1,980 MW planned facility in Chhattisgarh and will seek CDM registration for this as well, he stated. Melampati maintained that the revenue from carbon credits has been factored into constructing the competitive tariff (based on the lowest bid) charged by each UMPP. However,

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he admitted that a "moderate" carbon credit revenue stream was considered while evaluating project viability, taking into account the possibility that the UMPP does not qualify for CDM benefits. Melampati agreed that future power projects based on supercritical technology may fail to qualify under CDM as the technology becomes "commonly used" in India.

17. (SBU) Shishir Tamotia, CEO of Ispat Energy which is owned by the brother of steel magnate Lakshmi Mittal, stated that the objective of his company is to add 7,000 MW of power over the next five years with the least amount of carbon emissions. He said he would like to draw on the CDM incentive while achieving this target, but overcoming the additionality barrier may prove difficult. High energy prices and the cheap supply of equipment from China are making CDM projects viable without the CDM credit, he said. Ispat Energy is operating seven potential CDM projects, each at different stages of the approvals process. The project consultant is not optimistic about getting them registered with the CDM Executive Board, he admitted. If the projects fail to qualify for carbon credits, Tamotia continued, he will be forced to source sub-standard equipment from China rather than high-quality energy efficient technology from Europe and the U.S. It is difficult to justify the added cost of using green technology without a carbon credit revenue stream, he maintained.

18. (SBU) Ambuja Cements, a leading cement manufacturer in India, has two registered CDM projects. A 24 MW bio-gas power plant fuelled by rice husks to power the company's cement facility in Punjab earned 18,098 CERs in 2005. A blended cement project is awaiting verification and is estimated to generate 500,000 CERs per year. The company's cement operations across India were aggregated to create this project, which reduces carbon emissions by using less clinker and more additives like fly ash and slag. A company representative told us that the company expended 0.9 tons of carbon dioxide emissions per ton of cement manufactured five years ago. Carbon emissions have now

reduced to 0.6 ton per ton of cement manufactured as a result of blending additives with clinker. He also said that the company is planning to use industrial waste as a fuel substitute to manufacture cement, which will result in lower carbon emissions as this waste would have otherwise been incinerated in a commercial waste disposal facility. He acknowledged, however, that this project will not qualify for CDM benefits, as the reductions in carbon emissions are not direct and measurable. Kishore Kavadia, Advisor (Sustainability) of Ambuja Cements, claimed that the company's business is based on sustainable development and the CDM incentive is a "bonus" but not the "driver" of business operations. Most of the sustainable operations of the company were in place even before the CDM was conceptualized, he said. Nevertheless, Kavadia continued, carbon credit revenue improves the company's internal rate of return by 0.5-1 percent.

¶9. (SBU) Beroz Gazder, Vice President of Infrastructure Development of Mahindra & Mahindra, said that the company has obtained host country approval for several heat recovery projects to reduce carbon emissions. However, these projects are still stuck in the validation process due to the "additionality" and "business as usual" barriers. She asserted that the company will continue to focus on environmental sustainability even if the projects do not qualify for carbon credits. The group is looking at carbon credit revenue as a "by-product" of business and not as a "business opportunity", she added. Arun Jaura, the Chief Technology Officer of the Mahindra group, cited moral responsibility, customer's consciousness of the environment, regulatory requirements, long-term sustainability, and the desire to be an international player as reasons for initiating clean technology solutions.

...But Lash Out At the CDM Registration Process and Suggest Improvements

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¶10. (SBU) Ram Babu, the Managing Director of CantorCO2e's operations in India (a global project and emission trading consultant), believes that the CDM Executive Board's institutional mechanism and its modalities and procedures cannot address the potential opportunities of emission reduction. For example, he pointed out that avoiding de-forestation that potentially saves millions of tons of carbon emissions does not qualify for carbon credits. Babu also drew attention to the direct, real and measurable emission reduction requirement that ignores a number of initiatives that indirectly reduce carbon emissions. The Bandra-Worli sea-link which uses blended cement (clinker with additives like fly-ash) instead of ordinary portland cement cannot qualify as a CDM project, he noted. Establishing measurability increases project costs and accounts for 50 percent of the CDM benefit, Babu claimed. He complained that the CDM Executive Board is too "restrictive" in its thinking and implements the Kyoto Protocol with "blinkers". It is plagued with extreme bureaucracy and its decisions are arbitrary and ad-hoc in nature, he argued. The Board gives a one-line explanation for rejecting projects and does not justify its decision. There is no appeal mechanism and the Board's decision is final, he continued.

¶11. (SBU) DNV's Kutty admitted that there is no uniformity in the CDM Executive Board's decisions to qualify some projects and reject others. She also warned project developers to be more "conservative" when estimating carbon credits that can be generated by the project, as projects which fall short of the projected number of credits approved by the Board can later be rejected. Bhat of GTZ CDM urged companies to think of "innovative" ways to qualify CDM projects. She also emphasized that the time differential between implementing a project and submitting the project for validation should be kept to a minimum. Otherwise, the CDM Executive Board could rule that the project, already operating without the benefit of CERs, is sustainable without the CDM incentive, she warned.

¶12. (SBU) Tamotia complained of increased registration delays due to the shortage of staff and increased scrutiny of projects both by the CDM Executive Board and by validators. He suggests de-centralizing the Board's oversight by establishing more offices could avoid delays. He also pointed out that validators "overdo it and raise unnecessary objections to try and make things perfect". (Note: Validation and verification agencies are penalized if projects validated by them are rejected by the CDM Executive Board and may even get disqualified. End Note.) Kutty of DNV acknowledged that the actual validation process currently takes a minimum of 5-18 months now as compared to 2-3 months earlier. Registration with the CDM Executive Board takes another 2 months. Kashyap of Asia Carbon suggests that carbon credits generated during the validation and registration period can be sold in the voluntary emissions market which is outside the oversight of the U. N.

¶13. (SBU) Babu believes that the additionality test should be implemented with practical, commercial considerations. He echoed the view of Asia Carbon's Kashyap that the uncertainty of CDM revenue due to the risk of rejection makes it difficult to justify additionality in investment for even a single project. He said that CDM benefit is a bonus and noted that most of the projects are implemented even before being registered to earn carbon credits. Ambuja Cement's representative agreed and pointed out that CDM on its own does not generate enough carbon credit revenue to justify the project. Excluding "business as usual" projects from qualifying is "killing" Indian projects, he added.

¶14. (SBU) Somak Ghosh, President of Corporate Finance & Development Banking at Yes Bank, admitted that the bank does not consider the potential revenue stream from carbon credits while financing clean energy projects. The bank looks at clean energy projects which are viable independent of the CDM benefit. He pointed out that no bank would finance a project which is viable only with carbon revenues because of the uncertainty of the registration process, unclear guidelines on qualifying CDM

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projects and because carbon revenue is only a by-product revenue stream of the main operations of the company. He admitted that project developers prepare two balance sheets to secure funding: one showing the viability of the project without the CDM benefit (which is what the bank looks at) and another demonstrating the non-viability of the project without the CDM benefit. He complained that the investment additionality requirement is "designed to favor developed countries, create an income stream for consultants and keep good projects out of the market." Tamotia also recommends that the "additionality in investment" barrier be removed but believes that the "additionality in technology" requirement for CDM projects spurs innovation and encourages the use of the most energy efficient equipment.

¶15. (SBU) B Agarwalla, the Executive Director of Tata Power, argued that all measures resulting in improved energy efficiency should be eligible for carbon credits, even if they are adopted to enhance profitability. This will encourage more people to use energy efficient equipment to squeeze out every bit of energy from the process, he continued. Irani concurred and pointed out that enlightened people will go ahead and use energy efficient solutions even if the cost is 10-15 percent higher. Others however, need an incentive "to tip in favor of clean technology." Agarwalla pointed out that India has abundant coal resources and therefore coal will continue to dominate in the country's energy portfolio. Recognizing this, processes that are developed to make the most efficient use of coal should be encouraged and should earn carbon credits, he maintained.

CDM Scenario Going Forward..

¶16. (U) Bhat claimed that countries are putting pressure on the CDM Executive Board to improve the modalities and procedures to

qualify CDM projects. Some of the recommendations include immediate top-down guidance on programmatic CDM, automatic approval of projects below the sectoral baseline, simplified procedures for determining additionality for small-scale solar, wind, and hydro power projects, and transparent, consistent and non-discretionary decision-making by the CDM Executive Board. If all these are achieved then venture capital can flow to areas where CDM projects are scarce, she continued. Sethi said that the CDM Executive Board had discussed withdrawing the common use barrier for renewable energy projects but was not able to come to a uniform consensus.

¶17. (SBU) Separately, Bhat and Babu both theorized that the Kyoto Protocol would continue post-2012, albeit with a modified integrated arrangement, with emission reduction commitments from both countries and multinational corporations of major emitters in developed and developing countries. Babu noted that this new framework will address U. S. concerns as it ropes in major emitters from China and India. Tata Group's Agarwalla also believes that industries that emit the most should contribute the maximum to carbon reduction. Tamotia of Ispat believes that bilateral agreements between countries on emission reductions should be the way forward. He pointed out that setting sectoral emission standards, although desirable, will be difficult to implement, especially in the steel industry, as most of the steel plants in developed countries are old and less energy efficient. The investment to upgrade and modernize this equipment is considerable, so these companies will resist any move towards imposing sectoral emission caps, he said. The Indian government will also oppose sectoral emission caps in the steel industries, as state-owned Steel Authority of India is one of the least energy efficient steel companies in the country and uses outdated Russian technology, he claimed. (Note: However, it is important to note that a SAIL representative in Kolkata had said that the company had 70 potential CDM projects and voiced his approval for sectoral standards for the steel industry (see ref C). End Note.)

¶18. (SBU) Comment: All Indian executives with whom we spoke maintained that the CDM has "positively" benefited India but

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that the derived benefit could be much greater if the registration process is streamlined and qualification requirements relaxed. Amidst complaints about the "arbitrary" decisions of the CDM Executive Board, all interlocutors conceded that all Indian projects fail to meet the additionality in investment criteria and none should qualify for carbon credits. By their own admission, all of their clean energy projects are aimed at achieving sustainable development and will continue with or without the CDM benefit. The march towards "business as usual" clean technologies appears to be a logical step towards India's ascendancy to global competitiveness. Irrespective, all interlocutors emphasized that any process that uses cleaner technology or energy more efficiently should be "rewarded", especially given the high cost and finite availability of gas and fossil fuels. End Comment.
KEISER